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CHARLES ELMORE CROPLEY

No. 66

In the Supreme Court of the United States

OCTOBER TERM, 1946

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM ET AL., PETITIONERS

v.

JOHN AGNEW, F. O. FAYERWEATHER

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE PETITIONERS

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OPINION BELOW

The opinion of the United States Court of Appeals (R. 20–37) is reported at 153 F. (2d) 785. No opinion was rendered in the United States District Court for the District of Columbia.

JURISDICTION

The judgment of the Court of Appeals was entered on February 13, 1946 (R. 37–38). The petition for a writ of certiorari was filed on March 19, 1946, and granted on April 29, 1946 (R. 39). The jursdiction of this Court rests upon Section 240 (a)

of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether there is a right of judicial review of the action of the Board of Governors of the Federal Reserve System, taken under the provisions of Section 30 of the Banking Act of 1933, as amended (12 U. S. C. § 77), in ordering respondents' removal as directors of The Paterson National Bank, Paterson, New Jersey.

2. If so, whether the Board erred in holding that respondents were employed by a firm "primarily engaged" in the underwriting business, within the meaning of Section 32 of the Banking Act of 1933, as amended (12 U. S. C. § 78).

STATUTES INVOLVED

Section 30 of the Banking Act of 1933, c. 89, 48 Stat. 162, 193, as amended (12 U. S. C. § 77), provides as follows:

> SEC. 30. Whenever, in the opinion of the Comptroller of the Currency, any director or officer of a national bank, or of a bank or trust company doing business in the District of Columbia, or whenever, in the opinion of a Federal reserve agent, any director or officer of a State member bank in his district shall have continued to violate any law relating to such bank or trust company or shall have continued unsafe or unsound practices in conducting the business of such bank or trust company, after

having been warned by the Comptroller of the Currency or the Federal reserve agent, as the case may be, to discontinue such violations of law or such unsafe or unsound practices, the Comptroller of the Currency or the Federal reserve agent, as the case may be, may certify the facts to the Board of Governors of the Federal Reserve System. In any such case the Board of Governors of the Federal Reserve System may cause notice to be served upon such director or officer to appear before such Board to show cause why he should not be removed from office. A copy of such order shall be sent to each director of the bank affected, by registered mail. If after granting the accused director or officer a reasonable opportunity to be heard, the Board of Governors of the Federal Reserve System finds that he has continued to violate any law relating to such bank or trust company or has continued unsafe or unsound practices in conducting the business of such bank or trust company after having been warned by the Comptroller of the Currency or the Federal reserve agent to discontinue such violation of law or such unsafe or unsound practices, the Board of Governors of the Federal Reserve System, in its discretion, may order that such director or officer be removed from office. A copy of such order shall be served upon such director or officer. A copy of such order shall also be served upon the bank of which he is a director or officer, where-

upon such director or officer shall cease to be a director or officer of such bank: *Provided,* That such order and findings of fact upon which it is based shall not be made public or disclosed to anyone except the director or officer involved and the directors of the bank involved, otherwise than in connection with proceedings for a violation of this section. Any such director or officer removed from office as herein provided who thereafter participates in any manner in the management of such bank shall be fined not more than $5,000, or imprisoned for not more than five years, or both, in the discretion of the court.

Section 32, as amended (12 U. S. C. § 78), provides:

SEC. 32. No officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual, primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve the same time as an officer, director, or employee of any member bank except in limited classes of cases in which the Board of Governors of the Federal Reserve System may allow such service by general regulations when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments.

STATEMENT

On March 23, 1945, the Board of Governors of the Federal Reserve System (hereinafter referred to as the Board) issued an order removing respondents as directors of The Paterson National Bank, Paterson, New Jersey (hereinafter referred to as the Bank) (R. 6–7). The order was issued pursuant to authority conferred upon the Board by Section 30 of the Banking Act of 1933, 48 Stat. 193 (12 U. S. C. § 77), which provides, *inter alia*, that if, following a hearing, the Board finds that an officer or director of a national bank has continued to engage in unsafe or unsound practices or to violate any law relating to such bank after having been warned by the Comptroller of the Currency to discontinue such practice or violation, the Board in its discretion may order that such officer or director be removed from office. The finding upon which the Board's order in this case was made was that respondents had continued to violate Section 32 of the Banking Act of 1933, as amended (12 U. S. C. § 78), after having been warned by the Comptroller of the Currency to discontinue such violation (R. 7–14). Section 32 prohibits any officer, director or employee of any company, partnership or individual "primarily engaged" in the "underwriting" business from serving at the same time as an officer, director or employee of a national bank.

Respondents were both directors of the Paterson

Bank and employees of Eastman, Dillon & Co. (R. 9–10). The facts respecting respondents' employer are not in dispute. The Board, after hearing, found that Eastman, Dillon & Co. is engaged in the general brokerage and securities business with its principal place of business in the City of New York; that it advertises and holds itself out to the public as "Underwriters, Distributors, Dealers and Brokers"; that it acts as broker or principal in executing orders on the New York Stock Exchange, the New York Curb Exchange and the Philadelphia Exchange; that it buys and sells securities as broker or principal at wholesale or retail; that over an indefinite period the transactions of the firm in the "underwriting" field amounted to about 15 per cent of the total market value of the securities that were bought and sold by the firm during the same period; that the total number of its underwriting transactions during the same period approximated a similar percentage (15%) of the total number of the firm's transactions; that for the fiscal year ending February 28, 1943, 26 per cent of the firm's gross income was derived from its underwriting business, while 42 per cent of its gross income was derived from its brokerage business; that for the year ending February 29, 1944, 32 per cent of the firm's gross income was derived from its underwriting business, while 47 per cent of its gross income was derived from its brokerage business; that during 1943 the firm ranked ninth among 94 lead-

ing investment companies of the country with respect to its participations in bond underwritings; that for a period during such year it ranked first among such underwriters, excluding participations in municipal and railroad financings; and that the firm's participations in underwritings during 1943 amounted to $14,657,000 (R. 9–11).

In their original complaint respondents named only the Board as defendant, praying that a writ of certiorari issue to the Board to determine whether the Board "had jurisdiction and authority" to make the removal order (R. 5). They subsequently amended their complaint by adding the individual members of the Board as defendants and praying for alternative relief—asking either for the issuance of a writ of certiorari to the Board or for a mandatory injunction against the Board and its members requiring them "to vacate and set aside" the removal order (R. 16–17).

Petitioners moved to dismiss the complaint on the grounds that the court lacked jurisdiction of the subject matter and that the complaint otherwise failed to state a claim upon which relief could be granted (R. 17–18). The District Court dismissed the action, without opinion (R. 18–19). On appeal, the court below reversed, one judge dissenting (R. 20–37).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals for the District of Columbia erred:

1. In holding that the District Court had jurisdiction in the circumstances of this case to review the correctness of the Board's interpretation of the words "primarily engaged" within the meaning of Section 32 of the Banking Act of 1933.

2. In holding that the interpretation placed upon the words "primarily engaged" by the Board was erroneous.

3. In reversing the judgment of the District Court.

SUMMARY OF ARGUMENT

I

Absent a charge of fraud the Section 30 removal orders of the Board are not subject to judicial review in the courts. This is so because no express right of such review is provided in the statute, and all pertinent considerations point to the conclusion that Congress, in enacting Section 30, intended the Board's decisions thereunder to be final. The federal banking statutes generally provide no right of judicial review of the many administrative rulings which the banking agencies of the government are authorized to make, and the courts consistently have refused to engraft such a right upon those laws. Cf. *Adams* v. *Nagle*, 303 U. S. 532; *Bushnell* v. *Leland*, 164 U. S. 684; *Apfel* v. *Mellon*, 33 F. 2d 805 (App. D. C.), certiorari denied, 280 U. S. 585; *Raichle* v. *Federal Reserve Bank*, 34 F. 2d 910 (C. C. A. 2); *Bailey* v. *Tillinghast*, 99 Fed. 801 (C. C. A. 6); *Washington National Bank* v. *Eckels*, 57 Fed. 870 (C. C. W. D. Washington); *Liberty National*

Bank v. *McIntosh*, 16 F. 2d 906 (C. C. A. 4). Furthermore, the effectiveness of Section 30 proceedings would be nullified if a public inquiry into the reasons for the Board's order could be had in each case. The mere impact of a charge that a director or officer of a bank has been guilty of unsound, unsafe, or illegal practices might be sufficient in a critical time to destroy the bank itself. Congress recognized this danger and wrote a positive prohibition into Section 30 that the Board's removal order, and the findings upon which it is based, "shall not be made public or disclosed to anyone except the director or officer involved and the directors of the bank involved, otherwise than in connection with proceedings for a violation of this section." In this statutory setting the absence of an express provision for judicial review should be read as manifesting a Congressional intent that there should be no review. Cf. *Switchmen's Union* v. *National Mediation Board*, 320 U. S. 297.

The Administrative Procedure Act, passed after this Court granted certiorari, is inapplicable here, both because the statute was not meant to affect cases which have reached the appellate stage before its enactment, and because it does not alter the previous law as to judicial review in any respect material here.

II

The majority opinion below held that respondents' employer, while importantly and substan-

tially engaged in "underwriting" activities, is not "primarily engaged" therein because the volume of its "brokerage" business exceeded the volume of its "underwriting" business. Such an interpretation, described in the dissenting opinion of Judge Edgerton as "irrational", does violence to the obvious Congressional intent to remove from bank directorates those who, by their affiliation with organizations essentially or fundamentally engaged in underwriting activities, may be tempted to exert influence upon a bank or its customers in favor of that business. As Judge Edgerton further points out, whether a director may yield to such a temptation "does not depend in any degree upon the question whether the underwriting business is 51 per cent or 49 per cent of the business in which he is interested".

The Board's construction of the words "primarily engaged" gives effect to the general purpose of the statute stated above, and it does so without distorting the literal meaning of those words. Although it is true that the word "primarily" may mean "firstly" or "chiefly", it is also defined as "essentially" and "fundamentally". Clearly a word having slightly variant meanings should be given the only one which is consistent with the underlying purpose of the statute. On the other hand, if the majority decision below is permitted to stand, it will frustrate the Congressional purpose by permitting large un-

derwriting concerns to escape from the statutory prohibition.

ARGUMENT

I

IN THE ABSENCE OF A CHARGE OF FRAUD THERE IS NO REVIEW OF THE BOARD'S ORDERS ISSUED UNDER SECTION 30.

In determining when and to what extent judicial review of administrative rulings and decisions may be had this Court has not been governed by any rigid rules. It long since has determined, however, that, except where the Constitution commands it, there is no absolute "right" to such review. "The right of appeal is not essential to due process, provided that due process has already been accorded in the tribunal of first instance." *Ohio* v. *Akron Park District*, 281 U. S. 74, 80. Cf. *Reetz* v. *Michigan*, 188 U. S. 505. Even where administrative action has resulted in the taking of property, the Court has recognized that the legislature, in framing the law granting authority for such action, might appropriately act on "the policy that the greater good is sometimes secured by making certain classes of decisions final and ending litigation, even though in a particular case the individual is prevented by review from correcting some error which has injured him." *Crane* v. *Hahlo*, 258 U. S. 142, 148.

These principles are especially applicable where, as here, the administrative scheme concerns a subject over which the congressional power is

supreme and as to which there is no constitutional requirement of judicial review. Clearly a person chosen as an officer or director or employee of a member bank of the Federal Reserve system since the passage of Section 32 in 1933 takes the position subject to the restrictions which Congress has placed upon it. He has no vested or constitutional right to the office superior to the legislative limitations, including a limitation as to reviewability. In such cases "judicial review of administrative action may be granted or withheld as Congress chooses." *Estep* v. *United States,* 327 U. S. 114, 120. "Apart from constitutional requirements, the question whether judicial review will be provided where Congress is silent depends on the whole setting of the particular statute and the scheme of regulation which is adopted. *Switchmen's Union* v. *Mediation Board,* 320 U. S. 297, 301." *Ibid.* And where in such circumstances Congress has seen fit to make administrative action final, this Court has refused to supply judicial review even where alleged errors of law have occurred. *Switchmen's Union* v. *Mediation Board,* 320 U. S. 297.

It is recognized, however, that the question whether, in formulating a particular statutory scheme, Congress in fact intended to deny access to the courts to correct alleged administrative errors of fact or law does not always admit of easy solution. Certainly, "generalizations as to when judicial review of administrative action may

or may not be obtained are * * * hazardous." *Switchmen's Union* v. *National Mediation Board*, 320 U. S. 297. In ascertaining the congressional intent, especially as to statutes which are silent on the subject, there is need, as the Court emphasized in the *Switchmen's* and *Estep* cases, to consider the whole history and setting of the statute and the scheme of regulation which it was designed to embrace. The majority below has ruled that, notwithstanding the absence of any express provision therefor, there is a right of judicial review of the Board's orders issued pursuant to Section 30, and that such review may be afforded by the district court in the exercise of its general equitable jurisdiction. Its decision on this point is bottomed squarely upon the doctrinaire principle that, because the Board's ruling was predicated upon a construction of law, the content of that law "is a subject for judicial determination". (R. 24.)[1] Thus, in reaching its

[1] The majority opinion cites a number of cases, each of which arose under a statute containing a provision for judicial review, in support of the proposition that on "matters of law, unmixed, reviewing courts are free to substitute their own judgment" for that of the administrative office or agency (R. 25). This proposition is, of course, not disputed. Nor has the Board ever denied that the substantive issue here presented was one of law. The question here presented is not what rule is applicable when "reviewing courts" pass in judgment on decisions of administrative agencies, but rather what rule is applicable for determining whether Congress in a given statute intended there should be any review at all.

conclusion, the court below either ignored or rejected—at any rate it did not discuss—those considerations which this Court in the *Switchmen's* case, which also involved a question of law, said should be taken into account in determining whether or not to read a right of review into the statute. We turn now to a discussion of those factors in relation to the case at bar.

A. THE FEDERAL BANK SUPERVISORY SCHEME

Section 30 is but one of literally hundreds of legislative provisions which today comprise the federal bank supervisory scheme. The great bulk of those laws is contained in the National Bank Act, as amended,[2] originally passed in 1864, the Federal Reserve Act, as amended,[3] originally passed in 1913, and the Banking Acts of 1933[4] and 1935.[5] The latter two acts were largely amendatory of the first two, but in a few instances, as in the case of Section 30, they are complementary thereto. Responsibility for the administration of these statutes lies with the three bank supervisory agencies—the Comptroller of the Currency, who supervises national banks, the Board of Governors of the Federal Reserve System, which supervises member banks, and the Federal Deposit Insurance Corporation, which supervises non-member insured banks. Of course,

[2] 12 U. S. C. § 1, et seq.
[3] 12 U. S. C. § 221, et seq.
[4] 48 Stat. 162, c. 89.
[5] 49 Stat. 684, c. 614.

there is some overlapping and interlocking authority between these agencies, and occasionally, as in Section 30 proceedings, action by one agency is a necessary prerequisite of action by another. Only a very small percentage of the nation's banking institutions are not subject to some supervision by one or more of these three agencies.[6]

To each of the banking agencies has been granted extensive powers for regulating the banks within their respective jurisdictions. The comprehensive nature of these powers impelled this Court in *Cook County National Bank* v. *United States*, 107 U. S. 445, to say that the National Bank Act constitutes "by itself a complete system for the establishment and government of national banks." And it is particularly pertinent in this connection to note that, in granting such powers to the banking agencies, Congress consistently has used statutory language of the widest and most discretionary implications. From the first act of the organizers of an association formed under the National Bank Act to the last stages of receivership liquidations, national banks are subject to a wide variety of discretionary controls, principally under the aegis of the Comptroller of the Currency. Thus, the Comptroller is given authority to determine whether an association, formed un-

[6] There are approximately 14,000 commercial banks in the United States. Of these 5,012 are national banks, 1,875 are State member banks, and 6,446 are nonmember insured banks. See Federal Reserve Bulletin, August 1946, p. 931.

der the Act, may commence business;[7] changes in the capital structure of national banks may be had only subject to his "approval";[8] consolidations or conversions may be had only with his "approval";[9] branch banks may be opened only with his "approval";[10] he is authorized to "approve" certain exceptions to the making of loans in excess of statutory amounts;[11] he may by regulation permit national banks to act as insurance agents or brokers;[12] and, upon determining that a particular bank is insolvent, he may appoint a receiver therefor and generally supervise the receivership liquidation.[13]

The same broad language is likewise contained in the Federal Reserve Act. Thus, the Board "may" permit a bank to become a member of the Federal Reserve System;[14] if it should appear that a member bank has failed to comply with the Act or the Board's regulations, "it shall be within the power of the Board", after hearing, to require a member bank to surrender its membership, and the Board "may" restore such membership upon proof of compliance;[15] no organization

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[7] 12 U. S. C. §§ 26, 27.
[8] 12 U. S. C. §§ 51a, 51b, 57, 58, 59.
[9] 12 U. S. C. §§ 33, 34a, 35.
[10] 12 U. S. C. § 36.
[11] 12 U. S. C. § 84.
[12] 12 U. S. C. § 92.
[13] 12 U. S. C. §§ 63, 191.
[14] 12 U. S. C. § 321.
[15] 12 U. S. C. § 327.

formed for the purpose of doing a foreign banking business may commence operations before its articles of association and organization certificate have been "approved" by the Board;[16] and the Board is authorized "in its discretion * * * as the public interest may require" to grant or deny a permit to a bank holding company to vote the stock of its controlled banks.[17]

These are but a few examples of the broad sweep of discretionary power which Congress has lodged in the banking agencies of the Government. As may be seen, many of them involve the exercise of purely administrative discretion, while others, such as the Comptroller's power upon a determination of insolvency to appoint a receiver for a national bank, involve decisions upon matters of traditional judicial cognizance. Yet, upon none of them has Congress superimposed a right of judicial review for the benefit of those affected by the administrative action. In all four of the banking statutes referred to above there is only one instance in which Congress provided a right of judicial review upon any action by a banking agency, and that section is now obsolete.[18]

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[16] 12 U. S. C. § 614.

[17] 12 U. S. C. § 61.

[18] Section 47 of the National Bank Act (12 U. S. C. § 132) provides that the Comptroller of the Currency, upon notification that a national bank is in default on its circulating notes, may appoint a special agent to ascertain the fact. Such agent is to report to the Comptroller, who, if satisfied that the bank is in default, is authorized under Section 50 (12 U. S. C. § 192) to appoint a receiver for such bank. By the

Reference to that section, however, demonstrates that where Congress intended to provide such review it did so in clear and unmistakable terms. Clearly such a legislative course, pursued consistently in the banking statutes since 1864, can serve only to emphasize the Congressional intent to provide a system of banking supervision which can move swiftly, expertly, and definitively in meeting the difficult and often delicate banking situations which arise.

The above observations take on additional significance from another source. When Congress passed the Clayton Act in 1914 it wrote a section into the law prohibiting interlocking directorates between banks.[19] By Section 11 of that Act[20] it placed authority in a number of governmental agencies, including the Board, after hearing to order a person to "cease and desist" violations of that Act, including the section relating to interlocking directorates. Section 11, *inter alia*, also provided that any person required by an order of the Board "to cease and desist from a violation

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terms of the latter section, however, the bank within 10 days of the appointment of the special agent for the purposes stated above may "apply to the * * * district, or territorial court of the United States, to enjoin further proceedings in the premises" on the ground that it has not refused to redeem its circulating notes. These provisions are now obsolete, however, since national banks no longer issue circulating notes.

[19] 15 U. S. C. § 19.

[20] 15 U. S. C. § 21.

charged" might "obtain a review of such order" in a circuit court of appeals.

So far as agency action is concerned, therefore, Section 11 of the Clayton Act and Section 30 of the Banking Act provide for almost identical procedures. Under the Banking Act the Board determines, after hearing, whether an officer or director is continuing to violate any provisions of the banking laws, including the prohibition against interlocking directorates contained in Section 32. Under the Clayton Act the Board, after hearing, determines whether a person is violating any of the provisions of that Act, including the one against interlocking directorates contained in that statute. However, in the Clayton Act there is a provision for judicial review of agency action. In the Banking Act there is not.

A logical and we think compelling explanation of this difference lies in the different traditions respecting judicial review encompassed by the respective statutory schemes. In the Clayton Act the statutory injunction against monopolies and unlawful combinations covers the entire field of "commerce", of which banking constitutes only a relatively small segment. Under that Act, the principal burden of enforcement was put upon the Interstate Commerce Commission and the Federal Trade Commission, each of which already were exercising broad regulatory powers in the field of commerce. And in creating and defining the authority of each of those agencies Congress

had provided comprehensive provisions respecting judicial review of their respective administrative decisions.[21] Furthermore, the Clayton Act specifically was designed to "supplement existing laws against unlawful restraints and monopolies",[22] and this substantive problem already had acquired a background of judicial tradition derived in principal part from the cases arising under the Sherman Act. Thus, in providing for judicial review of agency action under the Clayton Act, Congress was acting in harmony with legislative and judicial precedents set in earlier and related statutory schemes.

However, the banking statutes, as we have seen, rarely implicate the judiciary in effectuating the Congressional purpose. In this field the tradition lies in an exactly opposite direction. Consequently, this is further ground for assuming that in failing to provide for judicial review in the Banking Act, Congress entertained the specific purpose to make agency action final and definitive. Cf. *Switchmen's Union* v. *National Mediation Board, supra.*

B. THE JUDICIAL HISTORY OF THE FEDERAL BANKING STATUTES

The opinion below is in sharp contrast with the position consistently taken at all levels of the federal judiciary that the decisions and orders of

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[21] See: 15 U. S. C. § 45, as to Federal Trade Commission; and 28 U. S. C. §§ 41 (28), 43–46, as to Interstate Commerce Commission.

[22] 38 Stat. 730, C. 323.

the banking agencies call for the exercise of expert judgment and discretion and, so long as they are made pursuant to lawful jurisdiction, and absent a charge of fraud, are beyond the powers of the courts to review.

Thus, this Court in *Bushnell* v. *Leland,* 164 U. S. 684, held conclusive the Comptroller's certificate of organization and refused to look behind his official determination. In *Apfel* v. *Mellon,* 33 F. 2d 805 (App. D. C.), certiorari denied, 280 U. S. 585, the court refused to test the sufficiency of the reasons which led the Board to disapprove the incorporation of a company attempted to be formed under the provisions of Section 25 (a) of the Federal Reserve Act, as amended (12 U. S. C. § 611, et seq.), to do a foreign banking business. Again, in *Raichle* v. *Federal Reserve Bank,* 34 F. 2d 910, the Second Circuit held that the courts were without power to review the action of the Board in changing the rediscount rates, it having been alleged that such action was ordered for the purpose of raising interest rates generally and to restrict the general supply of credit. In *Bailey* v. *Tillinghast,* 99 Fed. 801 (C. C. A. 6), the court refused to review the sufficiency of the Comptroller's certificate authorizing an increase in the bank's capital stock.

But it is in those cases growing out of the Comptroller's rulings resulting in the appointment of a receiver for a national bank and in levying assessments against stockholders under

the double liability provisions of the law where we find the most persuasive judicial precedents on the question. As indicated above, the Comptroller in taking such action makes decisions involving matters of traditional judicial cognizance, and there are striking analogies between such action and that of the Board taken pursuant to Section 30. In cases attacking the Comptroller's action in appointing a receiver for a national bank the courts consistently have rejected the plea to examine into the correctness of his decision. Thus, in *Wannamaker* v. *Edisto National Bank of Orangeburg*, 62 F. 2d 696, 700 (C. C. A. 4), the court said:

> The attempt in the bill to vacate the appointment of the receiver made by the Comptroller of the Currency and to enjoin the collection of the assessment upon the shareholders authorized by him, must likewise fail. We are dealing here with the extent of the power of the Comptroller to appoint a receiver for an insolvent bank, and to call for a ratable assessment upon its shareholders under the Act of June 30, 1876, § 1, 12 U. S. C. § 191 (12 USCA § 191); and it is settled that the determination as to the solvency of a national bank, and the necessity of an assessment against its shareholders, and the amount thereof, is committed exclusively to the judgment and discretion of the Comptroller, and it is not subject to judicial review.

In *Washington National Bank of Tacoma* v. *Eckels*, 57 Fed. 870, 872 (C. C. D. Wash.), the court pointed out that:

> the decision of the comptroller of the currency in this case, that the bank is insolvent, is to be taken as a finality. It is equivalent to the fact, whether the bank is really insolvent or not, so far as to authorize the exercise of the comptroller's power to put the bank in the hands of a receiver.

Again in *Liberty National Bank* v. *McIntosh*, 16 F. 2d 906 (C. C. A. 1927), the Court of Appeals for the Fourth Circuit pointed out that the jurisdiction of the Comptroller "in respect to all matters properly within his discretion is exclusive, and he is in respect thereto in no manner amenable to any court, nor is his action subject to review therein."

See also *Kennedy* v. *Gibson*, 8 Wall. 498, 505; *National Bank* v. *Case*, 99 U. S. 628, 634; *Bushnell* v. *Leland, supra; United States Savings Bank* v. *Morgenthau*, 85 F. 2d 811 (App. D. C.), certiorari denied, 299 U. S. 605, rehearing denied, 301 U. S. 666; *Harper* v. *Moran*, 76 F. 2d 980, 982.

In the comparatively recent case of *Adams* v. *Nagle*, 303 U. S. 532, this Court had under consideration the cognate question of the extent, if any, to which the Comptroller's action in ordering assessments, under the double liability provisions of the law, against stockholders of closed national banks may be reviewed by the courts. In the

course of its opinion the Court noted that several of the federal courts in similar proceedings had observed that such determinations by the Comptroller might be directly attacked for "clear error of law, fraud or mistake". This view the Court held "too broad" and indirectly, if not directly, limited the right to attack such action solely on the ground of fraud or bad faith on the part of the Comptroller. In its decision the Court used the following language which is particularly applicable here:

> The respondents rely upon decisions holding that a bill in equity or a writ of mandamus will lie to compel an executive officer to comply with the plain mandate of a statute. These have no application for they deal with a situation wholly foreign to that here presented. Where a statute vests no discretion in an executive officer but to act under a given set of circumstances, or forbids his acting except upon certain named conditions, a court will compel him to act or to refrain from acting if he essays wholly to disregard the statutory mandate; but if a discretion is vested in him, and he is to act in the light of the facts he ascertains and the judgment he forms, a court cannot restrain him from acting on the ground that he has exceeded his jurisdiction by reason of an error either of fact or law which induced his conclusion. *Plainly, therefore, the respondents are wrong in asserting that as the facts set*

forth in their bill charge the Comptroller with an error of law, he exceeded his authority.

The respondents further insist that their allegation that the Comptroller's action was "arbitrary," which is amplified and given content by the facts alleged and admitted by the motion to dismiss, requires a decree avoiding the assessment. The epithet "arbitrary," used in this connection, can mean no more than do the other averments that the Comptroller, in reaching his conclusion, "committed grave error of law" in failing to regard the contract of February 17 as effective. It would be arbitrary, in the proper sense of the term, for an official to act in the teeth of a statute or stubbornly to refuse to act at all where a statute commands action, but where he essays to exercise the jurisdiction conferred upon him, though his errors may be subject to subsequent correction, they cannot be enjoined as an arbitrary exercise of his authority. To hold otherwise would render orderly administrative procedure impossible.[23] [Italics ours.]

The authorities above cited make it abundantly clear that, because of the intricate and delicate

[23] Respondents did not charge, nor did the court below hold, that the Board acted "arbitrarily" in the instant case; indeed, in the face of such a strong dissent by Judge Edgerton (holding the Board's construction of the words "primarily engaged" correct, and the construction of those words by the majority below as "irrational") it could hardly be claimed that the Board acted "in the teeth" of the statute.

nature of the problems involved, the courts uniformly have refused to engraft a right of judicial review upon the decisions of the bank supervisory authorities made within their lawful jurisdictions.

C. THE PARTICULAR PLACE OF SECTION 30 IN THE FEDERAL BANK SUPERVISORY SCHEME

A vital portion of the basic jurisdictions of both the Comptroller and the Board is conferred upon them by Section 30. Nothing in the framework of that section nor in its legislative history suggests that, as to it, Congress intended a different rule to prevail with respect to judicial review than that which it had applied to those powers considered by the courts in the cases above referred to. On the contrary—and quite apart from the significant absence of any express statutory provision for judicial review—there are a number of considerations peculiar to Section 30 which require the conclusion that Congress particularly intended that no right of review should attach to the decisions made thereunder.

In the first place, until Section 30 was devised, the only effective power which the Comptroller had for dealing with an unsound management situation was the drastic one of closing the bank and appointing a receiver therefor—a power which he naturally was reluctant to use except in the clearest cases of insolvency. As pointed out by Senator Glass, who was the chairman of the subcommittee which conducted the hearings re-

sulting in the Banking Act of 1933, and who expounded its provisions to the Senate, the Comptroller frequently in the past had "been greatly perplexed and embarrassed" by the limitations upon his power. The Senator's remarks continued as follows:

> The comptroller has great reluctance to apply the drastic condemnation of the law. He waits, sometimes vastly too long, before he takes action. The comptroller now, who is a most worthy gentleman, scholarly, studious, courageous, I believe, in his testimony before the committee admitted that the comptroller's office—not himself, but the comptroller's office—had knowledge of the precarious condition of that large bank of Louisville the failure of which spread consternation and distress over a great part of that country and of another bank in Tennessee the failure of which did likewise; that the comptroller's office had knowledge that these banks were engaged in irregular and unsound if not actually illicit business five years before the failure came; that the files of the comptroller's office were replete with admonitory letters, with letters severely protesting against the practices in those banks over a period of years; but they did not close up the banks because of this reluctance of the comptroller's office to resort to that severe proceeding.
>
> I took the liberty of suggesting to the comptroller that he would have better

severely dealt with those banks five years theretofore, so that the failure which was inevitable when it came would not have been so extensive and disastrous. But he suggested, and we have acted upon the suggestion, that there should be a less drastic penalty. The only penalty now is to close up the banks. No matter how much he may admonish them, they disregard the admonition; they disregard what is called the "criticism" of the examiner and of the comptroller's office. So we have embodied in the bill a provision which authorized the comptroller and the Federal reserve agent, when a bank is found in irregular and illicit and unsound practices which it either fails or refuses to correct, to summon these bank officials to a court of inquiry and give them a thorough hearing and, if the facts sufficiently warrant it, to suspend or dismiss the officers of the bank.[24]

In supplying the banking agencies with this new power to remove an officer or director for unsound or illegal practices, the Congress obviously was acting in the belief that the expeditious use of such power might and would save the need for later invoking the more drastic one of closing the bank itself. And if the need for prompt and final action in the latter case be, as the courts have emphasized, ample reason for clothing the Comptroller's action in appointing a receiver with administrative finality, there is even more reason,

[24] 75 Cong. Rec. 9890.

we submit, for so concluding with respect to the Board's decisions under Section 30. In both situations there is a pressing need for prompt administrative action in order to prevent the evils of insolvency on the one hand, or unsound and illegal practices on the other, from causing further and perhaps disastrous financial consequences to the bank's creditors and stockholders.[25] Moreover, in appointing a receiver, the Comptroller pronounces the bank officially "dead", whereas in proceeding under Section 30 the Board is taking emergency measures to save its life.

Furthermore, in Section 30 proceedings we have not only to consider the dangers of *delay* incident to affording a removed officer or director his "day in court", but also the equally realistic dangers which a *public inquiry* into the *reasons* for the Board's action might entail. It cannot be doubted that the bank-depositor relationship is delicately hinged upon the confidence of the public. Mere

[25] Compare *Raichle* v. *Federal Reserve Bank*, *supra*, where the court observed that the idea of court intervention in reviewing the action of the Federal Reserve Bank in fixing the rediscount rate was "grotesque" since "the disease would ordinarily be long over before a judicial diagnosis could be made"; and *United States National Bank of La Grande* v. *Pole*, 2 F. Supp. 153, wherein the court pointed out that "since the protection of the public and the depositors is required, and the circumstances of emergency are such that there is often not time for court action without precipitating a catastrophe, the Legislative Department has seen fit to set the Comptroller over national banks and, in the statute which creates such associations, circumscribe the conditions of existence."

rumor can seriously impair that confidence. It follows that publicity of any sort to the charge that an officer or director is engaged in unsafe, unsound or illegal practices in the management of a bank would be sufficient in a critical time to destroy the bank itself. Under such circumstances it would be entirely illogical to suggest that, in devising a plan for the detection of potentially dangerous banking situations and the prevention of bank failures resulting therefrom, Congress intended to encumber its plan with a provision which might only serve to defeat its basic purpose.

That Congress intended to guard against such a result, however, is conclusively evidenced by the specific language of Section 30, which provides that the Board's order of removal, together with the findings of fact upon which it is based, "shall not be made public or disclosed to anyone except the director or officer involved, otherwise than in connection with proceedings for a violation of this section." It is not necessary to consider whether this prohibition is limited to the Board itself or extends to all parties involved in the proceeding.[25a] It is enough to say that it indicates a congressional desire to protect depositors and other persons interested in the solvency and soundness of a subject bank, by reducing to a minimum the disclosure of prejudicial facts. Since the pos-

[25a] The Government, of course, would not contend that the provision is a prohibition against free speech. The statute only relates to the publication of the Board's own order and finding.

sibility of judicial review of the Board's orders obviously would encourage the very publicity which the statute intended to avoid, the provision indicates how far from the mind of Congress was any thought that the orders of the Board would normally be judicially and publicly reviewable.

It is true, of course, that respondents' removal as bank directors was based upon a finding that they had continued to violate a banking law and not because they had participated in any alleged "unsafe" or "unsound" banking practices, and that the disclosure of the cause of removal in this case might not have affected the solvency of the bank. The section can hardly, however, be construed as differentiating between the cases it governs, so as to let publicity and reviewability depend on the likelihood that there will or will not be a run on the bank in the particular case. Furthermore, it cannot be said generally that the consequence of public disclosure that a bank director has violated one or more of the banking statutes will not be of the same character as the disclosure that a director has engaged in "unsafe" or "unsound" practices.

The Railway Labor Act contained no such express manifestation of legislative intent as is contained in Section 30. Nevertheless, in the *Switchmen's* case the court held that an administrative decision of the Mediation Board on a question of law could not be reviewed by the courts because the statutory scheme showed that no judicial re-

view was intended. We submit, therefore, that, judged in the light of the over-all pattern of federal banking legislation, the judicial history of that legislation generally, the need in Section 30 proceedings for prompt and definitive action, and the indication of a congressional intention that the Board's removal orders not be publicized, the rule applied in the *Switchmen's* case should be applied here. Jurisdiction in the courts to review Section 30 decisions should be denied on the ground that Congress intended that "the dispute was to reach its last terminal point when the administrative finding was made."

D. THE ADMINISTRATIVE PROCEDURE ACT DOES NOT AFFECT THIS CASE

The writ of certiorari in the present case was granted on April 29, 1946 (R. 39). On June 11, 1946, the President approved the Administrative Procedure Act (Public No. 404, 79th Cong., 2d Sess.), which in Section 12 provides, among other things, that

> This Act shall take effect three months after its approval except that sections 7 and 8 [Hearings, Decisions] shall take effect six months after such approval, the requirement of the selection of examiners pursuant to section 11 shall not become effective until one year after such approval, and no procedural requirement shall be mandatory as to any agency proceeding initiated prior to the effective date of such requirement.

The only section which could conceivably apply here would be Section 10—Judicial Review—

which became effective September 11, 1946. For the reasons pointed out below, pp. 34–36, we do not believe that this section was intended to change the scope of review applicable to a case such as the present one, nor to abrogate or limit the rule just discussed. But, in any event, and regardless of the scope of Section 10, we believe that its provisions are not and were not intended to apply to pending proceedings.

Neither in the Act nor its legislative history is there any reference to judicial proceedings seeking review of administrative action which had already been commenced. There is, throughout the legislative history, evidence of intent to afford the various agencies ample time to prepare and make such adjustments in their procedure as the provisions of the Act may require (H. Rep. No. 1980, 79th Cong., 2d Sess., p. 47; S. Rep. 752, 79th Cong., 1st Sess., p. 30), and this intent is underscored by the portions of Section 12 quoted above. It would be anomalous to suppose that Congress intended to make a procedural requirement of the Act inapplicable to an administrative proceeding initiated before the effective date of the requirement but applicable to a judicial proceeding concluded in the lower courts before the effective date of the requirement.[26]

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[26] The general principle that statutes are not to be construed retrospectively, see *United States* v. *Heth*, 3 Cranch 399, 413, is applicable also to statutes governing procedure. E. g., *United States* v. *St. Louis, etc., Ry. Co.*, 270 U. S. 1, 3.

It is not necessary in this case to determine the precise point at which Section 10 would apply. It is sufficient to note that to have that section apply, as here, at some appellate stage of a pending proceeding, would not make for certainty or stability of administrative action, and would be productive only of confusion. While undoubtedly Congress had the power to change the scope of judicial review so as to affect pending proceedings, even at the ultimate appellate stage, the consequences of such a change would be so unsettling that clear and unmistakable evidence of an intention to effect that result should be required. Here there is no such evidence. Accordingly, it seems clear that the provisions of Section 10, which went into effect on September 11, 1946, were, at the very least, not intended to affect the scope of judicial review in proceedings in which certiorari had been granted well before that date.

In any event, the terms and legislative history of the Administrative Procedure Act make it abundantly clear that Section 10 was designed, in general, to restate existing law, and that there was no disposition on the part of the Act's sponsors to change the rule, that administrative action under this statute is not to be judicially reviewed. The relevant portion of that Act is

contained in Section 10 which provides, *inter alia*, as follows:

> SEC. 10. Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion—
>
> (a) RIGHT OF REVIEW.—Any person suffering legal wrong because of any agency action, or adversely affected or aggrieved by such action within the meaning of any relevant statute, shall be entitled to judicial review thereof.

The provisions of Section 30 of the Banking Act are plainly of a type which "preclude judicial review" within the meaning of those words as used in the Administrative Procedure Act. That statute does not require that the preclusion be in express terms; indeed the word "express" as contained in an earlier draft of the bill was eliminated by the Senate Committee. Compare S. 7, 79th Cong., 1st Sess., as introduced in January 1945 with the bill as reported in S. Rep. No. 752, 79th Cong., 1st Sess., p. 36. As stated in the House Report accompanying that Act (House Report No. 1980, 79th Cong., 2d Sess., p. 41), "to preclude judicial review under this bill, a statute, if not specific in withholding such review, must upon its face give clear and convincing evidence of an intent to withhold it."[27] The setting and

[27] See also letter of Attorney General to Chairman of Senate Judiciary Committee under date of October 19, 1945 (Senate Report No. 752, 79th Cong., 1st Sess., pp. 37, 43),

background of Section 30, and the specific statutory injunction contained in Section 30 against public disclosure of the Board's orders and findings is "clear and convincing evidence" of the congressional intent to withhold judicial review.

II

THE BOARD CORRECTLY INTERPRETED THE WORDS "PRIMARILY ENGAGED" AS USED IN THE STATUTE

Should the Court conclude that the Section 30 rulings of the Board are reviewable generally in the courts, then the issue presented on the merits concerns the proper interpretation of the words "primarily engaged" as used in Section 32 of the Banking Act of 1933 (12 U. S. C. § 78). As pointed out above, that section prohibits any individual, who is employed by a firm "primarily engaged" in the "underwriting" business, from simultaneously serving as a director of a member bank. The Board's order removed respondents as bank directors because the Board found that their employer, Eastman, Dillon & Co., was primarily engaged in the underwriting business within the meaning of Section 32.

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wherein the Attorney General, in commenting upon the Administrative Procedure Act, specifically points out that Section 10 of that Act "declares the existing law concerning judicial review." The letter also calls attention to the fact that "A statute may in terms preclude judicial review or be interpreted as manifesting a congressional intention to preclude judicial review," citing as an example the *Switchmen's* case, *supra*, among others.

The majority opinion below reversed the Board's action on the ground that it had misconstrued the words "primarily engaged." It held that the Board should have applied a strictly quantitative test in construing those words and concluded that respondents' employer—which ranked ninth among 94 of the leading underwriting firms in the nation and which in one year alone did approximately $15,000,000 of underwriting business (R. 11)—was not "primarily engaged" in the underwriting business because the volume of its "brokerage" business and the profits therefrom exceeded that of its underwriting business. Thus, under the majority decision below, it becomes possible, notwithstanding the requirement of Section 32, for an employee of the largest underwriting firm in the country to serve as a bank director if 51% of the employer's business is brokerage, and 49% underwriting. *Per contra*, an employee of a firm doing an insignificant amount of underwriting may not serve as a bank director if the employer has even smaller quantities of other business.

Such a construction of "primarily engaged", as characterized by Judge Edgerton in his dissenting opinion, is "irrational". It imputes to Congress an intention to hazard the success of one of the important prophylactics in the 1933 Act upon so mercurial a test as a percentage comparison between different phases of an employer's business—where a difference of as little as a frac-

tion of 1% might be decisive one way or the other.[28] Clearly such a test, which leaves a gaping hole in the armor of the statute,[29] might lead to the absurd result, which the Board's opinion implied (R. 13), that the Act would apply to no one. In avoiding such an absurd result in other cases, this Court, as pointed out by Judge Edgerton, has not hesitated to apply "highly obscure and even wholly unheard-of meanings of ordinary words * * * in order to avoid a result which Congress did not intend" (R. 34). And the following statement of the Court in *United States* v. *American Trucking Association,* 310 U. S. 534, 543, is quite apposite:

> There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes. Often these words are sufficient in and of themselves to determine the purpose of the legislation. In such cases we have followed their plain meaning. When that meaning has led to absurd or futile results, however, this Court has looked beyond the words to

[28] If such be the test, is it to be applied yearly, quarterly, monthly, weekly or perhaps even daily?

[29] As pointed out in the dissenting opinion of Judge Edgerton, the statutory purpose is made perfectly clear by the express provision which authorizes the Board to make regulations which permit men within the prescribed class to serve as bank directors "when in the judgment of the said Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers regarding investments."

> the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words.

The Board's interpretation of "primarily engaged" provides a much more stable and less variable formula than that adopted by the majority below and seems more in harmony with the Congressional purpose. In substance it is this: An employer is "primarily engaged" in the underwriting business whenever such employer is "essentially" or "fundamentally" engaged in underwriting activities, for then the evil against which Section 32 was directed might be present if its employee were permitted to serve as a director or officer of a bank. This interpretation not only harmonizes with the statutory purpose but it is also literally correct. While it is true, as pointed out in the majority opinion, that the word "primarily" is defined as meaning "firstly" or "chiefly", and that this meaning carries a connotation of quantity, the word is also defined by reputable dictionaries[30] as "essentially" or "fundamentally". The latter meaning connotes substantiality and not merely proportional priority. In choosing between such definitions the Board em-

[30] Funk & Wagnalls' New Standard Dictionary; Webster's New International Dictionary; The Oxford Dictionary.

ployed a "normal process of statutory construction"; its purpose in doing so was "to give effect * * * to the probable intention of the legislature."[21]

Such has been the Board's consistent administrative interpretation of the section. While its rulings interpreting Section 32 have not generally been published, due to the confidential nature of the problem involved, the Solicitor General has been advised by the Board that since the enactment of Section 32 in June 1933 it has formally considered twelve requests posing the identical question here presented. Its rulings upon these requests, which covered a period running from July 1934, shortly after the statute here in question was enacted, up until 1944, are set out in the Appendix hereto, with the names deleted. In all of them the Board has interpreted the section as applying to companies which were substantially engaged in the underwriting business although not to the extent of over 50% of the business. The situation here, therefore, calls for the application of the settled rule that the practical and consistent interpretation for a long period of an ambiguous statute by the governmental agency charged with its administration is entitled to the highest respect and will not be disturbed except for very cogent reasons. *Skidmore* v. *Swift & Co.*, 323 U. S. 134; *Logan* v. *Davis*, 233 U. S. 613, 627; *Great Northern Ry.*

[21] See dissenting opinion (R. 35).

Co. v. *United States,* 315 U. S. 262, 275; *Norwegian Nitrogen Products Co.* v. *United States,* 288 U. S. 294, 315. As the Court stated in the last cited case, "The practice has peculiar weight when it involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new."

In overruling the Board's construction of "primarily engaged" the majority below purported to find support for their action in the wording of related sections of the Act as well as in the language of the report of the Banking and Currency Committee of the Senate (Senate Report No. 77, 73rd Congress, 1st Sess.) on the bill which ultimately became the Act. Before discussing these points in detail, however, it will be helpful briefly to advert to the circumstances giving rise to the Banking Act of 1933 and the purposes which it was designed generally to achieve.

The 1933 Act was essentially a reform measure. Since 1925 the banking structure of the country had suffered progressive deterioration, which had culminated in the Banking Holiday in March 1933. Bank failures had "reached an unprecedentedly high level after a long continued growth extending over a decade." (Senate Report No. 77, *supra,* p. 5). That this condition had contributed substantially to the stock market crash

of 1929 and the great depression which followed was acknowledged on all sides.

However, in passing the Banking Act of 1933 Congress did not attempt a complete revision of the federal banking laws. As pointed out in Senate Report No. 77, *supra*, p. 2, it was felt that "immediate emergencies were so great that it was wise to defer the preparation of a completely comprehensive measure for the reconstruction of our banking system, such as had been urged by some responsible men." Hence, it was decided "to construct a bill to correct manifest immediate abuses, and to bring our banking system back into a stronger condition." *Id.*

The bill itself contained 48 sections, covering a wide and heterogeneous topical range. Generally speaking, it erected safeguards against certain specific abuses, strengthened the hands of the bank supervisory agencies, increased the controls over the volume and use of bank credit, and provided for the insurance of bank deposits throughout the country.

Section 32 concerns but one facet of a much broader problem which is dealt with in a number of other sections of the Act. The Congressional inquiry had disclosed that, chief among the evils contributing to the 1929 panic, had been the practice, of comparatively recent origin, of the intermingling of the commercial and savings banking business with that of underwriting and the flotation of security issues. One of the symptoms of

this evil had been the rapid growth and development of the so-called "securities affiliate"—an organization either owned by or under common control with a bank, and engaged exclusively in the investment and underwriting business. In discussing this general subject, Senate Report No. 77 in pertinent part states as follows (pp. 8–10):

Condition of Member Banks

The outstanding development in the commercial banking system during the prepanic period was the appearance of excessive security loans, and of overinvestment in securities of all kinds. The effects of this situation in changing the whole character of the banking problem can hardly be overemphasized. National banks were never intended to undertake investment banking business on a large scale, and the whole tenor of legislation and administrative rulings concerning them has been away from recognition of such a growth in the direction of investment banking as legitimate. Nevertheless it has continued; and a very fruitful cause of bank failures, especially within the past three years, has been the fact that the funds of various institutions have been so extensively 'tied up' in long-term investments. The growth of the investment portfolio of the bank itself has been greatly emphasized in importance by the organization of allied or affiliated companies under State laws, through which even more extensive advances and invest-

ments in the security market could be made. * * *

* * * * *

Analysis of Present Banking Problem

2. *Banking affiliates.*—There seems to be no doubt anywhere that a large factor in the overdevelopment of security loans, and in the dangerous use of the resources of bank depositors for the purpose of making speculative profits and incurring the danger of hazardous losses, has been furnished by perversions of the national banking and State banking laws, and that, as a result, machinery has been created which tends toward danger in several directions.

(a) The greatest of such dangers is seen in the growth of "bank affiliates" which devote themselves in many cases to perilous underwriting operations, stock speculation, and maintaining a market for the banks' own stock often largely with the resources of the parent bank. This situation was never contemplated by the National Banking Act, and it would, therefore, appear that the affiliate system calls for the establishment of some legislative provisions designed to deal with the situation. It has been suggested from many quarters that the affiliate system be simply "abolished." This suggestion has much authority behind it, but, in addition to the manifest difficulty of enforcement, owing to the existence of well-known subterfuges to maintain control, there remains the question whether it would

be of much real service so long as State legislation permits the growth of affiliates in connection with State banks and trust companies. The committee has, therefore, determined to present proposed legislation aimed at the following objects:

(1) To separate as far as possible national and member banks from affiliates of all kinds.

(2) To limit the amount of advances or loans which can be obtained by affiliates from the parent institutions with which they are connected.

(3) To install a satisfactory examination of affiliates, working simultaneously with the present system of examination applicable to the parent banks.

With such considerations in mind Congress wrote into the bill a number of sections intended to separate the business of commercial and savings banking from that of underwriting. Thus, Section 20 of the Act[32] (12 U. S. C. § 377) provided,

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[32] Section 20 provides as follows:

"SEC. 20. After one year from the date of the enactment of this Act, no member bank shall be affiliated in any manner described in section 2 (b) hereof with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stock, bonds, debentures, notes, or other securities: *Provided*, That nothing in this paragraph shall apply to any such organization which shall have been placed in formal liquidation and which shall transact no business except such as may be incidental to the liquidation of its affairs."

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inter alia, that after one year "no member bank shall be affiliated in any manner described in section 2 (b) [33] hereof with any corporation * * * or other similar organization engaged principally in the * * * underwriting * * * of stocks, bonds, debentures, notes, or other securities".[34]

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[33] Section 2 (b) provides as follows:

"(b) Except where otherwise specifically provided, the term 'affiliate' shall include any corporation, business trust, association, or other similar organization—

"(1) Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; or

"(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank; or

"(3) Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank." (12 U. S. C. § 221a.)

[34] A related section to Section 20 was Section 21 (12 U. S. C. § 378), which provided that after one year it should be unlawful for any organization "engaged in the business of * * * underwriting * * * to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor".

In Section 19 [35] (12 U. S. C. § 61), in providing for the first time some measure of federal control over bank holding companies, Congress required that, in applying for a permit to vote its stock in controlled banks, the holding company must "show that it does not own, control, or have any interest in, and is not participating in the management or direction of, any corporation * * * or other similar organization formed for the purpose of, or engaged principally in * * * underwriting", etc. It further provided that if, at the time it filed its application, the holding company had any such prohibited interest, it should agree to "divest itself" of such interest within five years.

[35] Section 19 (e) provides as follows:

"(e) Every such holding company affiliate shall, in its application for such voting permit, (1) show that it does not own, control, or have any interest in, and is not participating in the management or direction of, any corporation, business trust, association, or other similar organization formed for the purpose of, or engaged principally in, the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities of any sort (hereinafter referred to as 'securities company'); (2) agree that during the period that the permit remains in force it will not acquire any ownership, control, or interest in any such securities company or participate in the management or direction thereof; (3) agree that if, at the time of filing the application for such permit, it owns, controls, or has an interest in, or is participating in the management or direction of, any such securities company, it will, within five years after the filing of such application, divest itself of its ownership, control, and interest in such securities company and will cease participating in the management or direction thereof, and will not thereafter, during the period that the permit remains in force, acquire any further ownership, control, or interest in any such securities company or participate in the management or direction thereof; and (4) agree that thenceforth it will declare dividends only out of actual net earnings."

Thus, Sections 19 and 20 were aimed specifically at the "affiliation" of banks with underwriting concerns; hence, the provision against the bank or its parent "controlling" or participating in the "management" of such companies. But there was also the danger, closely allied to that of direct "affiliation", that, through interlocking directors and officers, some of the evils of "affiliated" relationships might be perpetuated. Thus, a bank director, forgetting his fiduciary relation to the bank, might be tempted to use his influence to control the investment policies of the bank to the extent of making investments in securities which his employer might at the moment have for sale. Or, such an officer or director might be tempted to use the bank's depositor list to secure leads, and then to give investment advice to the bank's customers on the basis of purely personal and selfish considerations. These very alarms were sounded by Senator Bulkley when speaking on the "affiliation" subject at the time the bill was being debated in the Senate. He stated, in part, as follows:

> Obviously, the banker who has nothing to sell to his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment on which the bank is to receive an originating profit or

an underwriting profit or a distribution profit or a trading profit or any combination of such profits."[28]

The evil against which Section 32 was aimed is thus directly related to the evil against which Sections 19 and 20 were directed, namely, the intermingling of the banking and underwriting businesses. To such extent the three sections are thus *in pari materia*. But that does not require, as the majority below in effect concluded, that, in attaining the specific objectives sought by each section, there is necessarily a common test to be applied to all. Thus, the majority below pointed out that "in separating member banks from outside interests, [Congress] went only so far as to prohibit control." From this fact the majority reasoned that because the test of "control" may lie in the ownership of a "majority" of the shares of a corporation, such quantitative concept should be carried over and applied to the term "primarily engaged", as used in Section 32. Such a conclusion, we submit, is plainly a *non sequitur*. It ignores the distinction between the basic objectives sought by the different sections. Clearly, the fact that Congress felt that a majority of corporate shares might be essential to the "control" of a corporation is no ground for concluding that a bank director might be tempted to influence the investment policies of the bank and its customers only if 51% or more of his

[28] 75 Cong. Rec. 9912.

employer's business was that of underwriting. The dissenting opinion of Judge Edgerton clearly and concisely disposes of this phase of the majority opinion. He said:

> From the fact that Congress made a "majority" of one sort critical in sections of the Act where it used the word "majority," the court infers that Congress meant to make a majority of another sort critical in § 32 where it did not use the word. To me the opposite inference, if either, would seem to be suggested. But the contexts are so different that no inference is suggested. They are so different that the court's argument comes to this; by recognizing that majorities of votes control corporations, Congress implied that a man's qualification to serve as a bank director should turn upon a majority of the business activity in which he is engaged. The sections on which the court relies concern affiliates of banks. The purpose of Congress, in those sections, was to prevent banks from controlling underwriting corporations. Since control of a corporation depends upon control of a majority of directors, or ownership or control of a majority of voting shares or of shares voted, Congress made such majority control the measure of prohibited affiliation. In respect to the control of a corporation, 51 per cent of directors or of voting stock is a wholly different matter from 49 per cent. But in § 32 Congress did not aim at

> control, either of underwriters by banks or of banks by underwriters; and even if Congress had aimed at control, the question whether underwriting was or was not a majority of a firm's business would still have been irrelevant to its purpose. Section 32 is aimed only at the likelihood that a bank director who is interested in the underwriting business may exert influence upon his bank or its customers in favor of that business. The likelihood that he will do this does not depend in any degree upon the question whether the underwriting business is 51 per cent or 49 per cent of the business in which he is interested. The fact that Congress expressly treated a majority of voting power as critical where it makes sense to do so has no tendency to show that Congress meant to treat a majority of business activity as critical where it would not make sense to do so.

The same observations may be made concerning the conclusion, reached by the majority below, that because Congress did not intend to "abolish" the affiliate system, such fact "lends weight to the idea that in using the word 'primarily' in its description of the prohibited relationship in Section 32 of the Act, Congress intended a restricted scope rather than totality in the prescribed separation" (R. 30). In the first place, we fail to see any logical connection between the failure of Congress to take action abolishing affiliates and its positive action in directing that bank

directorates be freed from the potentially dangerous influences of directors employed by underwriting concerns. The Congressional purpose as to each such matter is obviously entirely different. In the second place, no one has contended that Congress prescribed "totality" of separation in Section 32; nor did the Board so construe that section. Under the Board's interpretation, only those firms which are "substantially" engaged in the underwriting business are brought within the definition of "primarily engaged".

The majority opinion below also purports to derive support for its interpretation of "primarily engaged" from the decisions of the Securities and Exchange Commission construing that and similar phraseology contained in the Public Utility Holding Company Act.[37] The opinion points out that, under Section 2 (a) (3) of that Act,[38] the Commission is authorized to exempt a utility company from the requirements of the law if it finds that such company "is primarily engaged in one or more businesses other than the business of an electric utility company". The opinion also refers to similar language contained in Section 3 (a) (3) of the Utility Act[39] which furnishes grounds for exemption to utility holding companies. The opinion goes on to point out

[37] 15 U. S. C. § 79.
[38] 15 U. S. C. § 79b (a) (3).
[39] 15 U. S. C. § 79c (a) (3).

that, while the Commission in construing these sections appears never to have defined the phrase "primarily engaged", nevertheless "the findings of fact underlying its conclusions appear always to have been quantitative in nature and it uses the terms 'principal business' and 'principally engaged' as synonymous with 'primarily engaged' ", citing a number of Commission decisions in support of this statement (R. 31).

The majority's reliance upon the Securities and Exchange Commission decisions seems misplaced. In the first place, the statutory setting and purpose of the words "primarily engaged" in the two statutes play exactly opposite roles in the respective statutory schemes. In the Utility Act the words are contained in a section which authorizes the Commission to hold that an applicant is *without* the law; whereas in the Banking Act the words are used as the basic test for bringing a particular situation *within* the law. As both statutes are remedial in nature exactly opposite rules of statutory construction are, therefore, applicable; exemption provisions are to be strictly construed against one seeking an exemption,[40] while provisions having an inclusive effect

[40] Cf. *Piedmont & Northern Railway Co.* v. *Interstate Commerce Commission*, 286 U. S. 299; *Spokane & Inland Empire Railroad* v. *United States*, 241 U. S. 344; *Berryman* v. *Board of Trustees of Whitman College*, 222 U. S. 334.

are to be liberally construed"—both rules predicated upon the principle of affording the fullest judicial range for accomplishing the legislative purpose.

Furthermore, the test of "primarily engaged" in the sections of the Utility Act referred to above is not, as is the case in Section 32, the *sole* test provided in such sections. The test of exemption in Section 2 (a) (3) is whether the utility "is primarily engaged in one or more businesses other than the business of an electric utility company, *and by reason of the small amount of electric energy sold . . . it is not necessary in the public interest*" that such company be made subject to the law. [Italics ours.] So that in granting or denying an application under this section the Commission must consider not only whether a utility is "primarily engaged" in "one or more" other businesses, but it must also consider whether such utility sells only a "small" amount of electricity to the public. And the Commission decisions cited by the court are at pains to develop the latter point. In each of those cases arising under Section 2 (a) (3) the Commission calls specific attention, among other things, to the relatively insignificant amount of electric energy which was being publicly sold by the applicant.[42]

[41] Cf. *Piedmont & Northern Railway Co.* v. *Interstate Commerce Commission*, *supra*, note 40; *Johnson* v. *Southern Pacific Company*, 196 U. S. 1; *Korbly* v. *Springfield Institution for Savings*, 245 U. S. 330.

[42] See *In the Matter of Aluminum Company of America*, 3 S. E. C. 640, 650; *In the Matter of Sloss-Sheffield Steel &*

The same may be said of Commission decisions interpreting Section 3 (a) (3). There the Commission's inquiry, in addition to whether the holding company is "primarily engaged" in other businesses, also includes whether such company is "*only incidentally*" a holding company and "not deriving * * * any material part of its income" from its utility subsidiaries. (Italics ours.) And in construing this section the Commission has flatly rejected a purely quantitative test as conclusive on the question of exemption. Thus, in *In the Matter of Cities Service Company*, 8 S. E. C. 318, it appeared that the applicant owned, directly or indirectly, a controlling stock interest in more than 150 operating subsidiaries doing business in 39 states and foreign countries and engaged principally in three industries—electric light and power, natural gas, and petroleum. The aggregate fixed assets of applicant's consolidated utility subsidiaries at book value represented only 47% of the book value of the fixed assets of all consolidated subsidiaries. In addition, the aggregate gross revenue of its consolidated utility subsidiaries was only 30% of its gross revenues from all sources. The applicant urged that, as it was "primarily engaged" in other businesses, such fact necessarily made it "only incidentally" a holding company within the meaning of Section

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Iron Company, 3 S. E. C. 460, 461; *In the Matter of International Paper Company*, 9 S. E. C. 937, 940.

3 (a) (3). In rejecting this argument the Commission stated, *inter alia*, as follows:

> "We are of the opinion, therefore, that the question whether a holding company satisfies this requirement of Section 3 (a) (3) must be determined in each case upon consideration of a variety of circumstances; such as the relationship between the gas and electric operations of the company's utility subsidiaries and the other business or businesses in which it is engaged or interested—*i. e.*, whether the business of the utility subsidiaries is incidental or accessory to the nonutility business or is wholly unrelated to it—the size of the company's utility subsidiaries and the scope of their operations, and, where the utility business is small, the company's stake in the utility business as compared with its interest in other lines of business.

The majority below also refers to a number of decisions interpreting the Bankruptcy Act, as amended. They call attention to the fact that Section 75 (r) of that Act [49] grants an exemption to a person "primarily bona fide personally engaged" in farming and that the courts in construing Section 75 (r) "uniformly recite quantitative tests" (R. 32).

Here again, however, the majority below has failed to take into account important distinctions

[49] 11 U. S. C. § 203 (r).

between the purpose and setting of the word "primarily" in the two statutes. Section 75 of the Bankruptcy Act deals generally with the subject of agricultural compositions and extensions. It provides for farmers the same type of relief from the ordinary processes of bankruptcy as Chapter X of the Bankruptcy Act [44] provides for corporations through the mechanism of reorganization. Section 75 (r) defines the word "farmer" both as it is used in Section 75 generally and as it is used in Section 4 of the Act,[45] which exempts a "farmer" from adjudication as an involuntary bankrupt. Clearly this statutory setting is as different from that of Section 32 of the Banking Act as are Sections 2 (a) (3) and 3 (a) (3) of the Utility Act from both. It is not to be supposed that Congress, in expressly creating certain rights and exemptions for "farmers", intended to extend those privileges to those who are engaged in a variety of other occupations to a substantial degree.

Furthermore, the test of "primarily" in the Bankruptcy Act, as the test of "primarily engaged" in the Utility Act, is not the *sole* test for determining who is a "farmer". Section 75 (r) defines a farmer as "an individual who is primarily bona fide personally engaged" in farming and also *"any individual . . . the principal part of whose income is derived from"* farming.

[44] 11 U. S. C. § 501, et seq.
[45] 11 U. S. C. § 22 (b).

[Italics ours.] Thus, in determining who is a "farmer" within the meaning of Section 75 (r), the courts are required to consider not only whether a person is "primarily bona fide personally engaged in farming" but also whether the "principal part of his income is derived" from farming. This fact tends to explain the judicial expressions quoted by the majority below and to mitigate their value, if any, as an accurate guide for construing "primarily" as used in Section 32 of the Banking Act.[46] Indeed, this Court has emphasized the *dual nature* of the test to be applied in determining who is a "farmer" within the meaning of Section 75 (r) and refused to fix an abstract meaning to either, holding that each case must be determined upon the basis of the "totality of the facts" disclosed by the record. *First National Bank & Trust Company* v. *Beach*, 301 U. S. 435.

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[46] One of the quotations referred to below—"The evidence does not support the conclusion that he was engaged chiefly in farming or tillage of the soil" (R. 32)—was taken from the case of *Swift* v. *Mobley*, 28 F. 2d 610 (C. C. A. 5, 1928), decided almost five years before the term "farmer" appeared in or was defined by the Bankruptcy Act. That case specifically involved Section 4 (b) of the Bankruptcy Act which exempted from involuntary bankruptcy "a person engaged *chiefly* in farming," etc. [Italics ours.]

CONCLUSION

For the foregoing reasons the judgment below should be reversed.

Respectfully submitted.

J. HOWARD MCGRATH,
Solicitor General.

ROBERT L. STERN,
Special Assistant to the Attorney General.

GEORGE B. VEST,
General Counsel,

J. LEONARD TOWNSEND,
Assistant General Counsel,
Federal Reserve Board.

OCTOBER 1946.

APPENDIX

FEDERAL RESERVE BOARD,
July 14, 1934.

DEAR SIR: Your letter of June 7, 1934, to the Federal Reserve Agent at [City], regarding your application for a permit under Section 32 of the Banking Act of 1933, to serve as a director of "X" Bank, as a director of "Y" Bank, and as a partner of "Z" and Company, has been referred to the Board for its consideration.

You request that the Board give further consideration to your application on the ground that "Z" and Company is primarily a stock exchange brokerage house and is not "engaged primarily in the business of purchasing, selling or negotiating securities." You state that for a period of years that firm has substantially retired from the underwriting business, with the exception of an occasional municipal issue and that strict brokerage for some time has constituted by far the principal part of its business and source of the firm's income. Also, you have furnished figures showing the comparative income from brokerage business and from trading and syndicate business which has accrued to the firm during the five years ending with 1933, and the percentages attributable to each type of such business.

The position taken by the Board in its letter to you in which it stated that it was unable to find that it was not incompatible with the public

interest to grant your application in this matter was based on information submitted by you indicating that the firm of "Z" and Company is a dealer in securities. Moreover, your letter shows that during the year 1933 the firm derived more than a quarter of a million dollars income from that type of business. Furthermore, the firm appears to hold itself out to the public as a dealer in securities as well as a broker and during the present month on two different occasions the firm's name has appeared before the Board as a member of a syndicate in connection with the applications of member banks for permits under Section 32 to perform the functions of a correspondent bank for such syndicate members pursuant to agreements for underwriting and selling securities.

In the light of the foregoing and all the circumstances involved, the Board does not believe that it may properly find that "Z" and Company is not primarily a dealer in securities within the meaning of the provisions of Section 32 of the Banking Act of 1933, despite the fact that its income from that business is less than its income from its brokerage business. As was stated in its previous letter the Board believes it was the purpose of Congress in enacting Section 32 to terminate relationships of the types described in that section between member banks and dealers in securities in the absence of special circumstances in the particular case which might justify the granting of a permit covering the relationships, and, in view of the policy as declared by Congress in the law, it is not the practice of the Board in cases of this kind to issue permits au-

thorizing interlocking officer or directorate relationships which fall within the scope of the prohibitions of Section 32. Accordingly, since there do not appear to be any special circumstances which would justify the granting of a permit in your case, the Board is unable to find that it would not be incompatible with the public interest to grant your application.

The Board is not unsympathetic with your wishes to continue to serve your firm and the two member banks, but as indicated above it believes that the facts pertaining to the type of business in which "Z" and Company is engaged are such as to bring that company within the scope of Section 32, and, in view of the purposes underlying the enactment of that section, the Board feels that it may not properly make an exception and grant a permit in your case. It will therefore be appreciated if you will advise the Federal Reserve Agent at the Federal Reserve Bank of [City], of the action which you take in order to comply with the provisions of the law.

Very truly yours,

(Signed) Chester Morrill

CHESTER MORRILL,

Secretary.

FEDERAL RESERVE BOARD,

July 24, 1934.

DEAR SIR: The Federal Reserve Board has given consideration to your application for a permit under Section 32 of the Banking Act of 1933 to serve as a director of the "X" Bank and as a partner of "Z" and Company, both of [City],

and to your letter of June 26, 1934, to the Federal Reserve Bank of [City] in which letter you have submitted additional information in connection with your application.

You have stated that the firm of "Z" and Company has not limited its business of dealing in and underwriting securities and proposes to continue such business as long as the laws governing the same permit. You also have shown that for the period from June 1, 1933 to May 31, 1934, the profits of the firm were as follows:

Commissions received	$155,232.21
Profit in interest account	34,504.85
Profit from investment, trading and syndicate accounts	38,722.99

The above figures represent the following percentages of the firm's total income:

Profit from commission account	68.0%
Profit from interest account	15.1%
Profit from investment, trading and syndicate accounts	16.9%

The Federal Reserve Board believes that it was the intent of Congress in enacting Section 32 to terminate all relationships of certain types between member banks and dealers in securities, apparently because it felt that such relationships might tend to influence in a manner which Congress deemed to be incompatible with the public interest the bank's credit and investment policies and their advice respecting investments to their correspondent banks and other customers. Consequently, the Board feels that it may not properly grant permits authorizing relationships which are actually of the kind referred to in that section and that its authority to issue such permits should be exercised only in exceptional cases, for example, those which are included within the literal terms of the statute but which are actually of a kind

different from the relationships at which its provisions were directed.

On the basis of the information submitted, the firm of "Z" and Company appears to be "engaged primarily in the business of purchasing, selling, or negotiating securities" within the meaning of Section 32, notwithstanding the fact that the profit derived by the firm from that type of business is less than its profit from other types of business carried on by the firm. In the circumstances, the relationship covered by your application appears to come within the class which the Board believes Section 32 was designed to terminate and it is therefore unable to find that it would not be incompatible with the public interest, as declared by Congress, to grant your application.

In the event that you desire to submit further facts or arguments in support of your application, the Board is prepared to give them careful consideration. However, any additional facts or arguments should be submitted as promptly as possible, in writing, to the Federal Reserve Agent.

Very truly yours,

(Signed) Chester Morrill

CHESTER MORRILL,

Secretary.

FEDERAL RESERVE BOARD,

August 16, 1934.

DEAR SIR: The Federal Reserve Board has given consideration to your application for a permit under Section 32 of the Banking Act of 1933 to serve as a director of the "X" Bank and as a partner of "Z" and Company.

It appears from the information which you

have submitted in support of your application that "Z" and Company is a stock exchange firm, with memberships on the New York Stock Exchange and the New York Curb Exchange and that for many years it also has maintained a Trading Department, the activities of which are largely confined to dealing in the preferred stocks of public utility companies, which stocks it buys and sells as principal. It has been stated that while the firm has never acted as underwriter in connection with the issue of securities and does not now participate in syndicates, it would engage in the latter type of business if opportunity permitted and that the firm has applied for registration as investment banker under the Investment Bankers Code. No figures have been submitted which show the relative proportions of the firm's commission business and its business as a dealer for its own account, although it appears that revenue from the latter type of business constitutes approximately 30 percent of the firm's total revenue.

The Federal Reserve Board believes that it was the intent of Congress in enacting Section 32 to terminate all relationships between member banks and dealers in securities apparently because it felt that such relationships might tend to influence in a manner which Congress deemed to be incompatible with the public interest the banks' credit and investment policies and their advice respecting investments to their correspondent banks and other customers. Consequently, the Board feels that it may not properly grant permits authorizing relationships which are of the kind referred to in that section and that

its authority to issue permits should be exercised only in exceptional cases such as those which are included within the literal terms of the statute but which are actually different from the relationships at which the provisions of the section were directed.

On the basis of the information which has been submitted, the firm of "Z" and Company appears to be "engaged primarily in the business of purchasing, selling, or negotiating securities" within the meaning of Section 32, notwithstanding the fact that the profit derived by the firm from that type of business appears to be less than its profit from the other types of business carried on by the firm. In the circumstances, the relationship covered by your application appears to come within the class which the Board believes Section 32 was designed to terminate and the Board is therefore unable to find that it would not be incompatible with the public interest, as declared by Congress, to grant your application.

In the event that you desire to submit further facts or arguments in support of your application, the Board is prepared to give them careful consideration. However, any additional facts or arguments should be submitted as promptly as possible, in writing, through the Federal Reserve Agent. If you do not wish to submit any such additional facts or arguments it will be appreciated if you will notify the Federal Reserve Agent of the steps which you take in order to comply with the provisions of Section 32.

Very truly yours,

CHESTER MORRILL,
Secretary.

FEDERAL RESERVE BOARD,
January 12, 1935.

Mr. "R"
Federal Reserve Agent,
Federal Reserve Bank of [City].

DEAR MR. "R": Reference is made to Mr. "P's" letter of October 22, 1934, regarding the application of Mr. "A" under the provisions of section 32 of the Banking Act of 1933 for a permit to serve as an officer and director of "X" Bank and the "Z" Company both of [City]. Mr. "P" inclosed a copy of a letter dated October 19, 1934, from Mr. "A", containing additional information regarding the business of "Z" Company.

As you know, there has been considerable correspondence regarding this application for the purpose of ascertaining the exact nature of the business of "Z" Company. The company apparently acts as dealer, broker, and investment counsellor. In a letter to the Comptroller of the Currency, dated August 10, 1934, the president of the national bank stated that "fully three-fourths of the business of the 'Z' Company comes from investment counsellor activities, and the direct sales represent a much smaller part". However, the subsequent correspondence has indicated that the investment counsellor activities include transactions in which the company also acts as dealer or as broker, receiving a single fee or commission for the entire transaction. Mr. "A" has stated that he finds it difficult to separate and allocate the income of the company to the three types of business in which the company appears to be engaged, although he has expressed

a sincere desire to furnish the required information.

However, in his letter of October 19, 1934, Mr. "A" has furnished figures showing that, for the year ending September 18, 1933, the company derived profits from participations in syndicates and selling groups and from selling concessions amounting to $5,678.75, and for the year ending September 18, 1934, profits from these sources of $7,871.41. For the former year it derived profits of $5,001.32 from the sale of securities belonging to it, and for the latter year profits of $1,030.18 from that source.

As you know, the Board believes that it was the intent of the Congress in enacting section 32 of the Banking Act of 1933 to terminate relationships of certain types between member banks and dealers in securities because of the possible undesirable effect which such relationships might have upon the member banks' investment policies and its policies in dealing with its customers. The Board has therefore taken the position that it may not properly grant permits covering relationships which are actually of the kind referred to in that section but that its authority to issue permits should be exercised only in exceptional cases, for example, those which fall within the literal terms of the statute but which are actually not within its intendment.

Of course, the denial of an application under these circumstances cannot be taken as implying that the particular relationship has actually been characterized by any of the undesirable practices which led the Congress to enact section 32, but signifies only that the Board is of the opinion

that the particular relationship is of a kind to which the Congress referred in section 32 and which the Board believes the Congress desired to terminate in order to avoid the dangers which it had in mind in enacting that section.

The information which has been submitted in connection with Mr. "A's" application indicates that the profits derived by "Z" Company from participations in syndicates and selling groups, from selling concessions, and from the sale of securities owned by the company, are substantial, and although the Board does not have definite information as to the total income of the company, it appears that such transactions comprise one of its primary activities.

For the reasons discussed earlier in this letter, the Board does not feel that under these circumstances it may properly issue a permit covering the relationship described in Mr. "A's" application.

In the event that Mr. "A" desires to submit further facts or arguments in support of his application, the Board, as you know, is prepared to give them careful consideration. However, any additional facts or arguments should be submitted to you, in writing, as promptly as possible; and, in the event that he does not desire to submit any further facts or arguments, he should be requested to notify you as to what steps he takes to bring his relationships in to conformity with the provisions of the law.

Very truly yours,

(Signed) Chester Morrill

CHESTER MORRILL,

Secretary.

FEDERAL RESERVE BOARD,
February 14, 1935.

Mr. "R"
Acting Federal Reserve Agent,
Federal Reserve Bank of [City].

DEAR MR. "R": Consideration has been given to the application of Mr. "A" under the provisions of section 32 of the Banking Act of 1933 for a permit to serve as a director of the "X" Bank and as a general partner of "Z" and Company, both of [City], which you recommended be denied in view of the nature of the relationship involved.

It appears that "Z" and Company is engaged in the brokerage business as well as in distributing securities and trading on its own account. For the three-year period ending June 30, 1934, the income of the firm was $249,844.59. On the basis of the information submitted, it appears that, of this sum, $197,016.64 was derived from acting as broker on behalf of others; $8,068.90 from trading on its own account; $34,759.05 from the distribution of investment trust shares as member of a distributing group; and $10,000 from the distribution on a commission basis of stock of "M" Company, a local corporation, which was not underwritten by the firm.

It thus appears, on the basis of the information which has been submitted, that approximately 14% of the firm's total income for the three-year period was derived from distributing investment trust shares as member of a distributing group, and that such income together with the income received from trading on its own account and the distribution of the "M" Company stock, comprised approximately 21% of the firm's total income for the period.

Moreover, as stated in the Board's letter of July 16, 1934, the business of "Z" and Company is described as follows in Calvin Bullock's "Security Dealers of North America" (1934 edition):

> "Underwriters, Participating Distributors & Dealers in Govt., Municipal, Public Utility, Industrial, Investment Trust & Real Estate Issues Specializing in Investment Trust Securities; Stock Brokers; Members of Distributors Group, Inc."

From a statement in the preface to that book it appears that a questionnaire is sent every six months to each firm listed. It is assumed, therefore, that the foregoing excerpt is based on information furnished by "Z" and Company.

Under the circumstances, the provisions of section 32 are apparently applicable to the relationships described in the first paragraph of this letter.

As you know, the Federal Reserve Board believes that it was the intent of Congress in enacting section 32 to terminate all relationships of certain types between member banks and corporations engaged primarily in the business of purchasing, selling or negotiating securities, apparently because it felt that such relationships might tend to affect in a manner which Congress deemed to be incompatible with the public interest the banks' credit and investment policies and their advice respecting investments to their correspondent banks and other customers. Consequently, the Board believes that it may not properly grant permits authorizing relationships which appear to be actually of the kind referred to in that section and that its authority to issue such permits

should be exercised only in exceptional cases, such as those which are included within the literal terms of the statute but which are actually of a kind different from the relationships at which its provisions were directed. However, the relationship covered by Mr. "A" 's application is apparently within the class which the Board believes the section was designed to terminate and it is unable to find that it would not be incompatible with the public interest as declared by Congress to grant his application. Therefore, unless there are other circumstances which you believe should be considered by the Board, it is requested that you advise Mr. "A" accordingly.

In the event that Mr. "A" desires to submit further facts or arguments in support of his application, the Board, as you know, is prepared to give them careful consideration. However, any additional facts or arguments should be submitted to you, in writing, as promptly as possible; and, in the event that he does not desire to submit any further facts or arguments, he should be requested to notify you as to what steps he takes to bring his relationships into conformity with the provisions of the law.

Very truly yours,

(Signed) Chester Morrill

CHESTER MORRILL,

Secretary.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
February 8, 1936.

Mr. "R",
Federal Reserve Agent,
Federal Reserve Bank of [City].

DEAR MR. "R": Consideration has been given to your letter of January 23, 1936, in which you state that, on the basis of the additional information which has been submitted, you believe that Mr. "A", who deals in securities under the name of "A" & Company, [City], [State], is "primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, of stocks, bonds, or other similar securities" and that he is therefore prohibited by section 32 of the Banking Act of 1933, as amended, from serving as a director of the "X" Bank.

The opinion of counsel for your bank, a copy of which you inclosed, reaches the same conclusion, pointing out that the information submitted by Mr. "A" shows that, in the conduct of his business, he purchases and sells securities as principal, and as agent for others, and also distributes securities "at retail under selling group agreements"; and that more than 50 per cent of his profits for each of the years 1931, 1932, and 1933, approximately 31 per cent of his profits for the year 1934, and approximately 46 per cent of his profits for the year 1935 were derived from the distribution of securities under selling group agreements.

As counsel for your bank points out, this information shows that the distribution of securities is one of Mr. "A"'s primary activities, and there-

fore the Board agrees with the conclusion reached by counsel for your bank that Mr. "A" 's service as a director of the national bank is prohibited by section 32 of the Banking Act of 1933. In the circumstances, it will be appreciated if you will advise the Board as to the steps which Mr. "A" takes in order to bring his relationships into compliance with the law.

Very truly yours,

(Signed) L. P. Bethea
L. P. BETHEA,
Assistant Secretary.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
September 25, 1936.

MR. "R",
Assistant Federal Reserve Agent,
Federal Reserve Bank of [*City*].

DEAR MR. "R": Receipt is acknowledged of your letter of September 14, 1936, requesting an opinion as to the applicability of section 32 of the Banking Act of 1933 to the services of Mr. "A" as a director of "X" Bank and as an employee of "Z" and Company, both of [City].

The Board sees no reason to differ with the conclusion reached by you and counsel for your bank that "Z" and Company should be deemed to be primarily engaged in the business referred to in section 32, and that the above relationships are, therefore, prohibited by that section.

Very truly yours,

(Signed) L. P. Bethea,
L. P. BETHEA,
Assistant Secretary.

NOTE: The information upon which the above conclusion was based was summarized in a memorandum to the Board from its Counsel reading as follows:

> The attached letter dated September 14, 1936, from Mr. "R", Assistant Federal Reserve Agent at [City], requests the opinion of the Board regarding the applicability of section 32 of the Banking Act of 1933, as amended, to the service of Mr. "A" as a director of "X" Bank of [City] and as an employee of "Z" & Co., both of [City].
>
> CONCLUSION
>
> The information submitted shows that section 32 is applicable.
>
> DISCUSSION
>
> Section 32 of the Banking Act of 1933 makes it unlawful for a director, officer or employee of a member bank to be at the same time a director, officer or employee of any corporation or partnership "primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities".
>
> The information which has been submitted indicates that the income of "Z" & Co. is derived from four principal sources: (a) commissions from the execution of orders for the purchase and sale of securities, as brokers; (b) income from investments, and income from commercial paper interest and commissions; (c) income from trading in stocks and bonds and foreign exchange for own account; and (d) income from the kind of business

described in section 32. For the six months' period ending June 30, 1936, the last-named constituted 46 per cent of total gross income, the trading described under (c) above produced about 36 per cent, and the remaining 18 per cent was derived from the other sources described above.

The information submitted is well summarized in the following quotation from the memorandum of counsel for the Federal Reserve bank which accompanied the letter of the Federal Reserve agent:

"* * * it appears that the annual gross income derived by that firm from transactions of the kind specified in section 32 in the two-year period from December 31, 1932, to December 31, 1934, was not in excess of 4.58 per cent of the total gross income, and that in the same period the annual gross income received by the firm from stock brokerage transactions at no time constituted less than approximately 12 per cent of the total gross income; that in the period from December 31, 1934, to January 1, 1936, the gross income derived by the firm from transactions of the kind specified in section 32 constituted approximately one quarter of the total gross income for the year, while in the same period approximately one third of the firm's gross income was derived from trading in stocks and bonds for the firm's account; and, that gross income received by the firm from transactions of the kind specified in section 32 in the six-months period from January 1, 1936, to July 1, 1936, constituted approximately 46 per cent of gross income, while in the same period less than 40 per cent of the firm income was attributable to trading in stocks and bonds."

The word "primarily" is not defined in section 32 or in the Board's Regulation R. However, the Board has ruled in several cases that an organization was "primarily engaged" in the business described in section 32 when such business produced less than 50 per cent of the total income but where such business was one of the primary activities of the organization. In the light of the Board's previous rulings, therefore, there would seem to be no doubt but that section 32 is applicable to a director of a member bank who is an employee of "Z" & Co. A letter to this effect is submitted herewith.

One further matter may be mentioned. As indicated above, one of the activities of "Z" & Co. consists in handling commercial paper, and Mr. "A" states that his activities have been in this section of the firm. He says that he does not sell anything to the bank. However, the wording of section 32 and of the Board's Regulation R would not permit of a conclusion that section 32 was not applicable on this ground, and neither the Federal Reserve Agent nor the memorandum of counsel makes any reference to it.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
September 23, 1937.

Mr. "R,"
Vice President,
Federal Reserve Bank of [City].

DEAR MR. "R": Further reference is made to your letter of August 9, 1937, regarding the applicability of section 32 of the Banking Act of

1933 to Mr. "A," who is a director of "X" Bank and a special partner in the firm of "Z" and Company, both of [City].

The memorandum opinfon of counsel to your bank which you inclosed summarizes the information which you have received regarding the business of the firm and discusses the question whether it is "primarily" engaged in the types of business referred to in section 32. The information shows that the types of business described in that section produced 16.3 percent of the total gross income of the firm for the year 1935, 22.6 percent for the year 1936, and 17.1 percent for the first four months of 1937. The percentages for the years 1933 and 1934 were very much lower.

In discussing the question whether the figures for the later years should be regarded as more indicative of the nature of the business of the firm than the figures for the previous years, your counsel points out that the February 1, 1937 issue of the "Monthly Review of Credit and Business Conditions" published by your bank indicates that for the first year since 1930 offerings of domestic securities approximated normal volume in 1936, and therefore concludes that in the case of "Z" and Co., the figure of 22.6 for the year 1936 should be regarded as more truly indicative of the nature of the business of the firm than the figures for the previous years.

On the basis of these considerations your counsel reaches the conclusion, with which you agree, that "Z" and Co. should be regarded as now being "primarily engaged" in the types of business spec-

ified in section 32, and that therefore Mr. "A" may not legally continue to be at the same time a special partner in that firm and a director of "X" Bank. You are advised that the Board agrees with this conclusion.

Very truly yours,

(Signed) L. P. Bethea
L. P. BETHEA,
Assistant Secretary.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
November 1, 1937.

Mr. "R,"
Vice President,
Federal Reserve Bank of [*City*].

DEAR MR. "R": Consideration has been given to your letter of October 18, 1937, regarding the question whether section 32 of the Banking Act of 1933 would prevent Mr. "A," who is a partner in the firm of "Z" and Company, from serving at the same time as a director of "X" Bank. The question depends upon whether the firm is "primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities" within the meaning of section 32.

The memorandum of counsel to your bank which you inclosed summarizes the information which you have received regarding the activities of the firm, and shows that syndicate participations and selling group commissions in connection with the flotation of new issues produced about 7.4 percent of the total gross income of the

firm. However, the memorandum shows that the firm also derives income from other transactions, in which it acquires large blocks of old securities and sells them to its clientele. The memorandum points out that in these transactions the firm does not enlist the services of salesmen or of associated firms, but merely notifies its clientele by telephone or circular letter that such securities are available at a stipulated price.

Section 32 was designed to prevent interlocking relationships involving the conflict of interests which would result from the service of an individual as a director of a bank, which was a potential purchaser of securities, and as a member of a firm which was seeking to promote the sale of such securities. The word "distribution" in section 32 clearly includes the distribution of new issues through selling group and syndicate participations. The wording and legislative history of the section show that it also includes so-called "secondary" distribution where the firm acquires a large quantity of an issue which has been outstanding for some time and distributes it to investors, because such "secondary distribution" involves a similar incentive to promote the sale of the securities.

In the present case, transactions of the latter kind produced about 12.7 percent of the total gross income of the firm, which, added to the amount derived from the distribution of new issues, constitutes such a substantial portion of the total income of the firm that the Board believes it should be regarded as "primarily" engaged in the kind of business described in section 32. Therefore, on the basis of the information which

has been submitted, it appears that the proposed service of Mr. "A" as a director of "X" Bank would be prohibited by the provisions of section 32 of the Banking Act of 1933.

It will be appreciated if you will advise Mr. "A" accordingly, unless you feel that a further investigation should be made of the facts regarding the sales of old issues by the firm or that there is some other reason why the matter should receive further consideration by the Board.

Very truly yours,

(Signed) L. P. Bethea
L. P. BETHEA,
Assistant Secretary.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
May 10, 1939.

Mr. "R",
Vice President,
Federal Reserve Bank of [*City*].

DEAR MR. "R": Receipt is acknowledged of your letter of May 3, 1939, enclosing copies of two letters from Mr. "A" with further reference to the applicability of section 32 of the Banking Act of 1933 to him.

The information submitted shows that for the three years 1936–1938 the business which he transacted as broker produced about 63 per cent of total gross income, and that sales for his own account produced about 37 per cent. He describes the latter type of business as comprising "the gross sales for my own account, which, you understand, were securities we were carrying." In a previous letter, he advised that he was carrying

an inventory of stocks, and also that he participated in syndicates, and retailed securities to the public. As explained in our letter of April 24, 1939 regarding this matter, this is the type of business referred to in section 32, and it constitutes one of his primary activities. Therefore, in harmony with the previous rulings of the Board in similar cases, section 32 should be deemed to be applicable to his services as director of the national banks.

It is assumed, of course, that Mr. "A" understands that the applicability of the statute depends simply upon a question of fact, namely, whether he is engaged in distributing and dealing in securities to such a substantial extent as to constitute one of his primary activities. If he is, the statute prevents his service as a director or officer of a member bank.

If Mr. "A" should feel that the facts have not been clearly understood, or that there are any additional facts or information which should be considered by the Board, the Board, of course, will be glad to give the matter further consideration.

Very truly yours,

(Signed) L. P. Bethea

L. P. Bethea,

Assistant Secretary.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
July 14, 1942.

Mr. "R",
Vice President,
Federal Reserve Bank of [*City*].

DEAR MR. "R": This refers to your letter of June 29 regarding the question whether Mr. "A" may continue to serve as a partner of "Z" & Company, and as a director of "X" Bank. You refer to the fact that in a letter to you dated June 12, 1936, the Board concurred in your opinion that on the basis of the facts then existing, "Z" & Company should not be regarded as "primarily engaged" in the business described in Section 32, but that in your letter replying to the inquiry regarding Mr. "A"'s eligibility, you pointed out that if there should be a material change in the character or relative volume of the various types of business transacted by the firm, a further question regarding the applicability of Section 32 might be presented.

You state that you have now been advised that during the intervening period, the proportion of the business of the kind described in Section 32 transacted by the firm is substantially larger than the proportion shown in 1936, and that it produced over 28 per cent of the aggregate gross income of the firm for the 6-year period ending April 1, 1942. In the circumstances, you informed Mr. "A" that the information submitted clearly indicated that "Z" & Company presently should be regarded as "primarily engaged" in the type of business described in Section 32, and that therefore he may not lawfully continue as a direc-

tor of a national bank while he continues his association with the firm.

As you know, the Board has considered a number of cases of this kind where the question was whether the type of business described in Section 32 was a sufficiently important part of the business of the firm to be regarded as one of its primary activities within the meaning of the statute. The facts shown in 1936 in connection with Mr. "A's" status at that time, presented a rather close question, but, as stated above, the Board saw no reason to differ with the conclusion reached by your bank. However, the Board agrees with you that on the basis of the information which has now been submitted regarding the nature of the business transacted by the firm during the 6-year period ending April 1, 1942, it is clear that the firm should now be regarded as "primarily engaged" in the type of business described in Section 32, and that Mr. "A" may therefore not lawfully continue as a director of the bank while he continues his association with the firm.

Very truly yours,

(Signed) L. P. Bethea

L. P. BETHEA,
Assistant Secretary.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
November 30, 1944.

Mr. "R,"
President, Federal Reserve Bank of [*City*].

DEAR MR. "R": This is in response to Mr. "Q's" letter of October 13, 1944, on the subject

of the application of section 32 of the Banking Act of 1933 to the continued service of Mr. "A" as a director of "X" Bank. Mr. "A", it appears, is also a partner in the firm of "Z" and Company. It is also clear that the firm of "Z" and Company engages in business of the kinds described in section 32, and your bank, following the precedents established by the Board in other cases, expressed the opinion to Mr. "A" and to "X" Bank that "Z" and Company is "primarily" so engaged within the meaning of section 32.

Mr. "M", president of the "X" Bank, questions the correctness of an interpretation of the word "primarily" which would result in the application of the statute to an interlocking relationship where the firm's business of the types described in section 32 does not constitute at least 50 percent of its total business. In these circumstances Mr. "M" wishes to arrange an interview in Washington.

The Board will be very glad to discuss the question further with Mr. "M" but, at the same time, believes that it is only fair that he should know in advance some of the factors which have influenced the Board in adopting the views heretofore expressed in other cases.

Section 32 is one of several measures enacted in 1933 designed to divorce commercial banking from investment banking. The general background of these provisions is fully and authoritatively discussed in Senator Bulkley's speech introducing the bill on May 10, 1932, reported in the Congressional Record beginning page 10222. In this speech Senator Bulkley described the

growth of the securities business in commercial banks and their affiliates, and the resulting conflicts of interest; he referred to the fact that commercial banks were not only in contact with prospective issuers of securities, but were also well situated to undertake the distribution of securities because of their relations with their correspondent banks; he referred to the use of lists of depositors as a means of distributing securities; and he referred to the rule of English and American jurisprudence that a trustee shall not sell to his trust. Certainly, the fact that 49 percent (as distinguished from 51 percent) of a firm's business happened to be underwriting would not, in itself, avert the consequences sought by the legislation.

It is a fact, of course, that one construction of the word "primarily" could lead in some cases to the adoption of a quantitative test such as Mr. "M" suggests. On the other hand, such is not the only accepted meaning of the word. It is frequently used in another sense. For instance, red is one of the "primary" colors but it is not the only primary color; Saturn is one of the "primary" planets but it is neither the only nor the largest one. Standard dictionaries cite as examples of the use of the word in the latter sense expressions similar to the expression "the *primary* causes of war".

The Board, in its prior considerations of the question, has always had in mind the rules of construction laid down by the courts that, while all of the words should be considered as having meaning, where a word used in a statute is susceptible of several meanings, that meaning should

be adopted which best accords with the intention of the legislature in enacting the statute and that a word used in a statute should not be construed to produce an absurd consequence when it is susceptible of another meaning in accord with the legislative intent. Under the quantitative test suggested by Mr. "M", underwriting could be one of the essential or fundamental parts of the company's business but, unless it constituted at least 50 per cent of the total, the business of the firm would not come within the scope of the statute. Presumably if the firm engaged in three types of business, each of which constituted a third of its total business, it would not be primarily engaged in any business. Indeed, in the light of the reduced amount of underwriting, in relation to the other types of business in which underwriting firms engage, which has taken place since the enactment of the statute, it might well be that there would be no firms to which section 32 would be applicable.

These are the circumstances which have caused the Board to construe the word "primarily" in a different sense from that suggested by Mr. "M". Moreover, while it has always looked at the sources from which a particular firm derives its operating revenue, it considers that factor as but one of all the factors. It also considers such factors as the purposes and functions of the organization, the business which it holds itself out as doing, and such other circumstances as may have a bearing upon the question.

Every interlocking relationship of the type described in section 32, of course, did not result in the consequences which the statute was designed

to prevent. However, it seems clear that Congress, in order to prevent such a consequence, directed its attention to the elimination of the relationships. Accordingly, while the Board is in sympathy with Mr. "M's" desire to retain experienced and qualified directors, it has not felt that it could properly construe section 32 in the manner he suggests.

As to a date for Mr. "M" to come to Washington, it is suggested that a mutually convenient date can best be arranged through your bank as intermediary. Please have Mr. "M" advised of the substance of this letter.

Very truly yours,

(Signed) Chester Morrill

CHESTER MORRILL,

Secretary.